

Auditor's report

Nkomazi Local Municipality

30 June 2014

Report of the auditor-general to the Mpumalanga Provincial Legislature and the council on the Nkomazi Local Municipality

Report on the financial statements

Introduction

1. I have audited the financial statements of the Nkomazi Local Municipality set out on pages ... to ..., which comprise the statement of financial position as at 30 June 2014, the statement of financial performance, statement of changes in net assets, cash flow statement and statement of comparison of budget information with actual information for the year then ended, as well as the notes, comprising a summary of significant accounting policies and other explanatory information.

Accounting officer's responsibility for the financial statements

2. The accounting officer is responsible for the preparation and fair presentation of these financial statements in accordance with South African Standards of Generally Recognised Accounting Practice (SA Standards of GRAP) and the requirements of the Municipal Finance Management Act of South Africa, 2003 (Act No. 56 of 2003) (MFMA) and the Division of Revenue Act of South Africa, 2013 (Act No. 2 of 2013) (DoRA), and for such internal control as the accounting officer determines is necessary to enable the preparation of financial statements that are free from material misstatement, whether due to fraud or error.

Auditor-general's responsibility

3. My responsibility is to express an opinion on these financial statements based on my audit. I conducted my audit in accordance with the Public Audit Act of South Africa, 2004 (Act No. 25 of 2004) (PAA), the general notice issued in terms thereof and International Standards on Auditing. Those standards require that I comply with ethical requirements, and plan and perform the audit to obtain reasonable assurance about whether the financial statements are free from material misstatement.
4. An audit involves performing procedures to obtain audit evidence about the amounts and disclosures in the financial statements. The procedures selected depend on the auditor's judgement, including the assessment of the risks of material misstatement of the financial statements, whether due to fraud or error. In making those risk assessments, the auditor considers internal control relevant to the entity's preparation of the financial statements in order to design audit procedures that are appropriate in the circumstances, but not for the purpose of expressing an opinion on the effectiveness of the entity's internal control. An audit also includes evaluating the appropriateness of accounting policies used and the reasonableness of accounting estimates made by management, as well as evaluating the overall presentation of the financial statements.
5. I believe that the audit evidence I have obtained is sufficient and appropriate to provide a basis for my qualified audit opinion.

Basis for qualified opinion

Property, plant and equipment

6. In terms of GRAP 17 *Property, plant and equipment*, an entity shall recognise items of property, plant and equipment that qualify for recognition as assets in the financial statements. Contrary to this requirement, the municipality did not recognise all assets in its financial statements, as selected assets could not be traced to the asset register.
7. Furthermore, as the municipality did not have adequate systems to accurately calculate the depreciation, the accumulated depreciation was overstated by R8 943 136.
8. Consequently, I was unable to determine whether any further adjustments were necessary to the property, plant and equipment of R1 495 604 673 (2013: R1 368 917 054) disclosed in note 5 to the financial statements and the statement of financial position and the depreciation expense of R49 189 967 (2013: R50 053 977) disclosed in note 37 to the financial statements and the statement of financial performance.

Qualified opinion

9. In my opinion, except for the effect of the matter described in the basis for qualified opinion paragraph, the financial statements present fairly, in all material respects, the financial position of the Nkomazi Local Municipality as at 30 June 2014 and its financial performance and cash flows for the year then ended, in accordance with SA Standards of GRAP and the requirements of the MFMA and DoRA.

Emphasis of matters

10. I draw attention to the matters below. My opinion is not modified in respect of these matters.

Material losses

11. As disclosed in note 58 to the financial statements, material losses of R84 738 123 (2013: R64 297 698) and R24 167 382 (2013: R26 701 471) were incurred as a result of water distribution losses and electricity distribution losses, respectively. This represents 90% (2013: 89%) of the total water purchased and 32% (2013: 37%) of the total electricity purchased.

Material impairments

12. As disclosed in notes 8 and 10 to the financial statements, material impairments relating to receivables from non-exchange transactions and consumer debtors from exchange transactions of R22 488 372 and R4 711 260, respectively, were incurred as a result of the provision for doubtful debt.

Additional matter

13. I draw attention to the matter below. My opinion is not modified in respect of this matter.

Unaudited disclosure notes

14. In terms of section 125(2)(e) of the MFMA, the municipality is required to disclose particulars of non-compliance with the MFMA. This disclosure requirement did not form part of the audit of the financial statements and, accordingly, I do not express an opinion thereon.

Report on other legal and regulatory requirements

15. In accordance with the PAA and the general notice issued in terms thereof, I report the following findings on the reported performance information against predetermined objectives for selected development objectives presented in the annual performance report, non-compliance with legislation as well as internal control. The objective of my tests was to identify reportable findings as described under each subheading but not to gather evidence to express assurance on these matters. Accordingly, I do not express an opinion or conclusion on these matters.

Predetermined objectives

16. I performed procedures to obtain evidence about the usefulness and reliability of the reported performance information for the following selected development objectives presented in the annual performance report of the municipality for the year ended 30 June 2014:
- Development objective 1: basic service delivery on pages ... to ...
 - Development objective 4: good governance and public participation on pages ... to ...
17. I evaluated the reported performance information against the overall criteria of usefulness and reliability.
18. I evaluated the usefulness of the reported performance information to determine whether it was presented in accordance with the National Treasury's annual reporting principles and whether the reported performance was consistent with the planned programmes. I further performed tests to determine whether indicators and targets were well defined, verifiable, specific, measurable, time bound and relevant, as required by the National Treasury's *Framework for managing programme performance information* (FMPPi).
19. I assessed the reliability of the reported performance information to determine whether it was valid, accurate and complete.
20. The material findings in respect of the selected development objectives are as follows:

Good governance and public participation

Reliability of reported performance information

21. The FMPPi requires auditees to have appropriate systems to collect, collate, verify and store performance information to ensure valid, accurate and complete reporting of actual achievements against planned objectives, indicators and targets. Significantly important targets were not reliable when compared to the source information or evidence

provided. This was because the validity of the reported achievements was not frequently reviewed against source documentation.

Additional matter

22. I draw attention to the following matter:

Achievement of planned targets

23. Refer to the annual performance report on pages ... to ... and ... to ... for information on the achievement of the planned targets for the year. This information should be considered in the context of the material findings on the reliability of the reported performance information for the selected development objectives reported in paragraph 20 of this report.

Compliance with legislation

24. I performed procedures to obtain evidence that the municipality had complied with applicable legislation regarding financial matters, financial management and other related matters. My findings on material non-compliance with specific matters in key legislation, as set out in the general notice issued in terms of the PAA, are as follows:

Strategic planning and performance management

25. The performance management system of the municipality did not provide for steps to be taken to improve performance with regard to those development priorities and objectives where performance targets were not met, as required by section 41(1)(d) of the Municipal Systems Act of South Africa, 2000 (Act No. 32 of 2000) (MSA).
26. The annual performance report for the year under review did not include the performance of the municipality, a comparison of the performance with set targets, and a comparison with the previous financial year, as required by section 46(1)(a), (b) and (c) of the MSA.

Budgets

27. Expenditure was incurred in excess of the limits of the amounts provided for in the votes of the approved budget, in contravention of section 15 of the MFMA.

Annual financial statements, performance report and annual report

28. The financial statements submitted for auditing were not prepared in all material respects in accordance with the requirements of section 122 of the MFMA. Some material misstatements of current assets, liabilities and disclosure items identified by the auditors in the submitted financial statements were subsequently corrected, but the uncorrected material misstatements resulted in the financial statements receiving a qualified audit opinion.

Procurement and contract management

29. Sufficient appropriate audit evidence could not be obtained that goods and services with a transaction value below R200 000 had been procured by means of obtaining the required price quotations, as required by supply chain management (SCM) regulation 17(a) and (c).
30. Sufficient appropriate audit evidence could not be obtained that bid specifications for procuring goods and services through competitive bids had been drafted in an unbiased manner that allowed all potential suppliers to offer their goods or services, as required by SCM regulation 27(2)(a).
31. Contracts were awarded to bidders based on points given for criteria that differed from those stipulated in the original invitation for bidding, in contravention of SCM regulations 21(b) and 28(1)(a) and the *Preferential procurement regulations*.
32. The preference point system was not applied in all procurement of goods and services above R30 000, as required by section 2(a) of the Preferential Procurement Policy Framework Act of South Africa, 2000 (Act No. 5 of 2000) (PPPFA) and SCM regulation 28(1)(a).
33. Contracts were awarded to bidders that did not score the highest points in the evaluation process, contrary to section 2(1)(f) of the PPPFA.
34. Contracts were awarded to bidders who did not submit a declaration on whether they are employed by the state or connected to any person employed by the state, as required by SCM regulation 13(c).
35. Construction projects were not always registered with the Construction Industry Development Board (CIDB), as required by section 22 of the CIDB Act of South Africa, 2000 (Act No. 38 of 2000) and CIDB regulation 18.
36. Construction contracts were awarded to contractors that did not qualify for the contract, contrary to section 18(1) of the CIDB Act and CIDB regulations 17 and 25(7A).
37. The performance of contractors or providers was not monitored on a monthly basis, as required by section 116(2)(b) of the MFMA.
38. Contracts were awarded to providers listed on the National Treasury's database as persons prohibited from doing business with the public sector, in contravention of SCM regulation 38(1)(c).

Human resource management and compensation

39. An acting head of the SCM unit was appointed for a period of more than three months without the approval of the member of the executive council for local government, in contravention of section 56(1)(c) of the MSA.
40. The annual report of the municipality did not reflect information on compliance with prescribed minimum competencies, as required by minimum competency levels regulation 14(2)(b).

Expenditure management

41. Money owed by the municipality was not always paid within 30 days, as required by section 65(2)(e) of the MFMA.
42. Reasonable steps were not taken to prevent unauthorised and irregular expenditure, as required by section 62(1)(d) of the MFMA.

Revenue management

43. An effective system of internal control for revenue and debtors was not in place, as required by section 64(2)(f) of the MFMA.

Asset management and liability management

44. An effective system of internal control for assets was not in place, as required by section 63(2)(c) of the MFMA.

Consequence management

45. Irregular expenditure incurred by the municipality was not investigated to determine if any person is liable for the expenditure, as required by section 32(2)(a)(ii) of the MFMA.

Internal control

46. I considered internal control relevant to my audit of the financial statements, annual performance report and compliance with legislation. The matters reported below under the fundamentals of internal control are limited to the significant deficiencies that resulted in the basis for the qualified opinion, the findings on the annual performance report and the findings on compliance with legislation included in this report.

Leadership

47. The accounting officer did not exercise oversight responsibility regarding financial and performance reporting and compliance as well as related internal controls.

Financial and performance management

48. Management did not ensure that controls were implemented over daily and monthly processing and reconciling of transactions.
49. Management did not prepare regular, accurate and complete financial and performance reports that were supported and evidenced by reliable information.
50. Management did not review and monitor compliance with applicable laws and regulations.

Governance

51. The audit committee and internal audit unit operated effectively during the period under review as per their legislated mandate. Recommendations were made to management on the improvement of internal controls to ensure reliable reporting of both financial and performance information as well as compliance with legislation. However, this did not result in improved controls, due to management not implementing the recommendations, which led to the adverse assessment of the impact of this committee and unit.

Auditor-General

Mbombela

29 November 2014



AUDITOR-GENERAL
SOUTH AFRICA

Auditing to build public confidence